**D R A F T**

# MINUTES
## Legislative Study Commission on Public-Private Partnerships
**November 30, 2010, at 9:30 a.m.**
**Room 1228, Legislative Building**
**Co-Chairman Deborah Ross, presiding**

Co-Chair Ross called to order the first meeting of the Joint Legislative Commission on Public-Private Partnerships at 9:30 a.m. on Tuesday, November 30, 2010. The following members of the committee were present: Senator Clark Jenkins, Co-Chair; Senator Margaret Dickson; Senator Bob Rucho; Representative Larry Bell; Representative Becky Carney; Representative Bill McGee; Ms. Angela Carmon; Mr. James N. Copeland; Mr. William J. Klein; Ms. Mary Nash Rusher; Ms. Gloria Shealey; and Mr. Richard E. Vick. A copy of the agenda and a roster of visitors to the meeting are available at in the 11-30-2010 folder at the Commission's website: http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121.

Chairman Ross asked the Commission members to introduce themselves. Please see the Commission's website for a complete listing of Members' Backgrounds under General Information at: http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121.

Chairman Ross recognized General Assembly staff members present: Margie Penven, assistant to Representative Ross and to the committee; Mark Bondo, Heather Fennell, and Greg Roney with the Research Division; and Ben Stanley with the Bill Drafting Division. Assistant Sergeants-at-Arms present were Reggie Sills and John Brandon from the House and Charles Marsalis and Charles Harper from the Senate.

Chairman Ross said it was the intention of the chairs for this Commission to meet twice before the first of the year and at least once before the 2011 Session begins. She said the next meeting would be on December 15th, and the schedule for January will be set after that meeting. She asked that members notify the committee assistant of any potential calendar conflicts in January.

Chairman Ross said public-private partnerships have been an issue of interest in the state through the Emerging Issues Forum and also among the legislators for the past couple of years. She said there have been small bills with not nearly as robust a discussion as there have been in some other states. She said today there would be an overview of public-private partnerships issues. She said Mr. Rich Little, visiting from California, would speak about transportation projects; and Mary Nash Rusher, Commission member, would speak about a wide variety of other projects to give the Commission a flavor of what has already been accomplished here in North Carolina.

At the December 15 meeting, Chairman Ross said the Commission would get a synopsis and picture of the newly enacted Virginia law to see what they have learned and where they are.

In January, Chairman Ross said the Commission would try to come up with some principles for any kind of public-private legislation that might come up during the upcoming long session. She said they might look at some other models, and they would call on their members to give information to staff, if they have ideas they think the Commission should consider. Chairman Ross said there were very knowledgeable people in the audience including people from the State Treasurer's Office who would have to be consulted on any public-private partnership legislation.

If it is possible to have draft legislation, it might be recommended out of this committee; but because it is a long session coming up and the Commission is not required to offer legislation, any member may offer legislation during the session with a lot more flexibility for drafting and for when the legislation might be introduced. She said it was very important, however, that the knowledge and the recommendations of this Commission be put forward so whatever the next session of the General Assembly does, it does it with the Commission's knowledge and with the knowledge that there are a number of stakeholders out there who would want to have input on anything that is done.

Chairman Ross asked Heather Fennell to go over the charge of the Commission. A copy of the charge is available on the Commission's website in the General Information folder http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121.

Chairman Ross introduced Mr. Richard G. Little. He is a Senior Fellow in the School of Policy Planning and Development and Director of the Keston Institute for Public Finance and Infrastructure Policy at the University of Southern California. Mr. Little teaches, consults, conducts research, and develops policy studies aimed at informing the discussion of infrastructure issues critical to California and to the nation. Mr. Little has lectured and published extensively on life cycle management and financing of infrastructure, risk management, and decision making for critical infrastructure. He has been certified by the American Institute of Certified Planners, and is Editor of the Journal *Public Works Management and Policy*. Mr. Little was elected to the National Academy of Construction in 2008, and in 2009 was appointed to the California Public Infrastructure Advisory Commission to assist the state in implementing public-private partnerships for transportation. He holds his MS in Urban Environmental Studies from Rensselaer Polytechnic Institute. Chairman Ross said the Commission was happy that Mr. Little was able to make time in his schedule to be present.

Mr. Little said he was honored and pleased to have the opportunity to come and address this Legislative Study Commission. He said it is in his wife's and his immediate-range plans to re-locate to North Carolina.

He said he has thought for a long time that the U. S. and the states individually have not done what has been needed to be done with infrastructure, and as we have rolled through the most recent financial crisis and look to the future, we find ourselves in a bind of (1) needing infrastructure for various purposes but (2) not being as flush with capital as we have been in the past. The question is what do we do and how do we do it? He said that was the gist of his presentation today. (A copy of Mr. Little's PowerPoint presentation is available in the 11/30/2010 folder at: http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121.

Mr. Little said we are on the verge of a perfect storm in funding civil infrastructure. There are a number of factors coming together that multiply to make the final outcome much larger than might have been expected. Why? The needs in the country are huge. The figures shown on slide 2 come from the American Society of Civil Engineers' Infrastructure Report Card, and whether one agrees with the figures, the fact is that we have built a huge enterprise in the U. S. that we call the Infrastructure System. Much of it has been put in place since WWII, and much of it was put in place before WWII. It's old and getting older, and there has not been the capital reinvestment strategy that goes along with building these things. We hear how China is building such a large percentage of its GDP on infrastructure, and we're spending a much smaller percentage. That is not surprising because China up until recently had nothing. China is a huge country, and they are trying to connect it all together much as we were trying to connect the U. S. through the latter part of the Nineteenth and early part of the Twentieth Centuries. Having said that, Mr. Little said we haven't spent what we should have been spending all along and that is catching up to us.

The Federal Highway Trust Fund is basically broke and relying on General Fund transfers. Mr. Little referred to an article he wrote for a newsletter about the Trust Fund, and that handout can be found under the heading 11/30/2010 at the Commission's website, http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121. Mr. Little said when the Interstate System was conceived and approved in the 1950s it came along with a revenue source to pay for it, which was the federal gas tax. The tax went into the Trust Fund, and the federal government was able to make grants available to the states on a 90-10 or an 80-20 basis. It was a very effective way of tying up a lot of geography with a modern highway system.

Mr. Little said the gas tax has not been increased in 17 years at the federal level, things have become much more expensive, and the tax is not indexed; so there is a lot less money to do what we thought we wanted to do.

As we have heard recently about the deficit and debt, the federal government on the current course is in a bad way. The bar chart (slide 6) is about a year old. The very bottom bar is interest on the national debt, which as time goes on grows rather precipitously. Right above that bar is Social Security, which remains pretty constant and is probably the least of our concerns because it actually does have a funding stream. The bar above that is Medicare, which is a huge issue because that does not have the same kind of funding steam, and those costs are increasing all the time. Last, the white shows everything else. The thick black horizontal line is current revenue projections. So as we go out over time, the ability to buy anything else besides debt service, Social Security, and Medicare is actually running out. This indicates that we are going to need some changes either in how we raise money or how we fund things, because looking to the federal government for a lot of help is going to be futile.

Mr. Little said North Carolina's needs are formidable as well. Slide 4 shows the 2009 update for the ASCE report card for the state. North Carolina got a little higher grade than the country as a whole, which is good. The three top concerns were roads, schools, and wastewater. He said that although he is primarily talking about transportation, what he has to say about PPP transcends this. The idea will work for anything that the public sector currently builds; it's just a question of how we are going to do it.

One of the other factors thrown in is pension funds; and depending on where you live, this is either an issue or not. In many places, public pension funds have real shortfalls going out into the future. They are looking for places to get better returns than they have been getting; and a lot of projections indicate that the money isn't going to be there, particularly in the State of California. This is a huge issue, and Illinois also has problems. Most of the large states with large pension funds have not been putting aside enough money, and we have funds trying to make up the shortfall. On top of that, the financial crisis hit a lot of the funds particularly hard. In California they lost about 25 percent of their value, and they are trying to make this up.

Slide 8 depicts the borrowing and paying back conundrum. Taken from California data, the lower (red) line is available revenue after paying operating expenses. The top (blue) line is debt service on already approved debt issues. Mr. Little said you don't need an MBA to see that it is not a sustainable business model where your expenses are going up and your revenues are going down. He said many states face the same problem, and simply borrowing to get out of current difficulty is not an option for many places.

Mr. Little said one of the questions one might ask is, how is all that going to affect the "traditional model" for providing infrastructure in the U. S.? (Slide 9) He said the fact is, there really isn't any traditional model; it just depends on where you look. Over time we cycle back and forth between public ownership and private ownership. In the early days of the Republic, most of our roads and canals were private enterprise, many of which went bankrupt several times before they actually got built and up and running, and now we tend not to think about that. If we think about the Erie Canal and some of our major roadways, they are now pretty much in public ownerships, so we've forgotten that, but there never has been one model for the U. S. Particularly in the U. S., more than other places, we've inserted an additional level or two of governance and regulation. He said he was at a meeting in Scotland a couple of weeks ago with a bunch of UK and EU investors, and they were talking about national issues. Mr. Little said he was amused to hear about the Spanish Transport Policy or the Dutch Transport Policy—what the national government is doing, and they are then in turn the ones that go out and actually buy the projects. Mr. Little thought to himself, if only it was so simple? The fact of the matter is that after you go through the federal level, which more and more has less to do with providing infrastructure, you have state interests, local interests, and regional interests. So the United States is, in fact, unique; but that also provides us with a lot more opportunity to use innovation because we have so many different governance levels and ways of raising revenue.

Even though we have not been investing what we should, Mr. Little said there is nothing new here. We have pretty much followed a pattern in the U. S. in that we tend not to react early to issues; we wait for clear and present dangers and then do something about them. We have had periods of neglect, and then we see a lot of activity. Then things settle down again, and then we replay the record over again. The Slide 10 diagram captures this. As soon as anything happens such as bridges falling down or 911, initially there is a huge spike of interest on the part of the public and certainly on the part of legislatures to do something, and that is quite normal. Over time, interest sinks back. With the current emphasis these days on what goes on at airports, a lot of people have put 911 to the back of their minds. It is seizing those teachable moments, which is when interest is really high. Slide 11 depicts the Cuyahoga River in Cleveland, Ohio. Back in the 50s and 60s there were a lot of refineries and other petroleum work done on the river, and they discharged all their waste to the river. Petroleum products being light, they tended to float on top of the water, and occasionally the river would catch fire. One of these large fires happened right about the time of the Pollution Control Act amendments, initially passed in 1972. So the timing was right there. There is a river on fire because of pollution, and we got a very comprehensive pollution control act passed, which funded most of the water cleanup in the country over the next two decades.

The Silver Bridge between Ohio and West Virginia collapsed in the 70s, but in the 70s and 80s a lot of bridges fell down. Congress eventually noticed, and they told the FHWA to put a program in place to fix this. During the late 80s and 90s, in particular, there was a spate of bridge work going as these bridges were replaced. Mr. Little said we have a history of doing that, but recently we have kind of moved away from that. We had the New Orleans disaster in 2005, which Mr. Little thought was the ultimate wakeup call, and nothing much happened. And then we had the I-35 bridge fall down in Minneapolis in 2007, and the bridge got rebuilt. In Los Angeles in 2009, there was a disaster due to the result of a lot of water main blowouts. In the City, much of the system of the Department of Water and Power is very old, and because of continual drought conditions in Southern California, they had introduced lawn watering on Tuesdays and Thursdays. So everyone watered, and every Tuesday morning and every Thursday morning everyone's sprinklers would go on and there was a huge pressure jolt and big pipes were bursting. Eventually they stretched out their watering schedules and there have not been nearly as many pipes bursting. The question is, what's become of teachable moments? Mr. Little said these happen every two years, so he can't wait until next year to see what happens.

What do we do and how do we pay for it? Mr. Little said that is the fundamental question of why the Commission is meeting, but he said a policy issue should be addressed first:  Are infrastructure services a public good, a market commodity (something people shop for), or something in between? He said there is no question that public safety is a public good. He said we tend to treat highway transportation as a public good even though we do charge people a little for it. For things like electricity, natural gas, and communications, people get a bill every month and they pay it. So that question has very profound implications for how we fund and finance what we want to do because there are only two ways to pay for infrastructure:  either taxes or fees. And even if you get money from somebody else, they're getting money from taxes or fees.

Mr. Little said if we are talking about a public good, we generally look to taxes in one form or another; and if we are talking about a market commodity, we generally look at fees. But the point is, if we don't want to think about taxes to pay for infrastructure, we're going to have to charge fees. Or, the option to all this is, we don't do anything. And that's been part of the dilemma the country's been hung up on for quite a while. There's been a great reluctance to increase taxes and, at the same time, in many parts of the country there's been a great reluctance to charge fees. And with no money you tend to get no infrastructure.

Mr. Little said back in the dark days when he studied economics it was simple. You could have guns or butter. The economics was you did this or you did that, and that was a pretty simple way of doing it. Today, we have much more complex decisions, and this is being played out at the federal level with the discussions of budget deficits and national debt. He said we have just had a report from the co-chairs of the President's Debt Reduction Committee, and they came up with a whole bunch of things that would work. But, of course, nobody likes them because they think someone else's program should be cut and someone else's taxes should be increased. Today's decisions must achieve multiple objectives and satisfy many stakeholders (Slide 17).

Where do we get new money to make needed investments? (See Slide 18.) Mr. Little said you could look at new taxes such as general taxes, property taxes, income taxes, target taxes. He said California has targeted sales taxes specifically for transportation. Los Angeles County in 2009 approved Measure R, which was a small percentage sales tax increase that is estimated to bring in $40 billion over the next 20 years. That's a lot of money that people have volunteered to tax themselves, and there are lots of arguments about why that's perhaps not the best way to do this because it tends to distance the actual user of transportation from the way you pay for it. But that's one way of raising money, and that's been very popular in California where the gas tax is as popular as it is anywhere else. When something like Measure R passes it indicates a high degree of support among the citizens because it needs 2/3 of the voters to pass.

Mr. Little said you can go to user fees, which are various forms of tolls. Arguably the gas tax is at its basic level of user fee; it's tied into how much fuel you consume, which used to be a pretty good measure of how much you drive. When everyone got 12 miles to the gallon everything was pretty equal, but now you can go from 12 miles to the gallon to 70 or 80 miles to the gallon. And we're moving into hybrids and electrics, and if you buy a Volt and plug it at home you can use the highway system for free. If you imagined an all-electric highway fleet, money for highways would disappear tomorrow. But you can do direct tolling and other forms of tolling, and you can use revenue from asset monetization, which is basically converting public re-owned into a revenue source and turning the operation over to the private sector. As one of the first slides indicated, Mr. Little said we cycle back and forth in this country from private to public and maybe the cycle is going back to private ownership. Whether or not that is bad or good depends on what you are trying to achieve. Mr. Little said he had no strong advocacy position for anything, he just thinks it is important to put all the options out there.

Mr. Little said what he came to talk about is how to increase the leveraging of public monies using private capital through what is basically called public-private partnerships, which are a whole range of financing and procurement methods for infrastructure projects. He said at the end of the day what we need is new ways of thinking about what we do, how we do it, and how we pay for it.

Mr. Little said PPPs are nothing more than contractual agreements between the public and private sectors to deliver services in exchange for a fee. How that gets structured tends to vary quite a bit. He said the running joke in the PPP community is that if you've seen one PPP, you've seen one PPP. They all tend to be unique. He said his personal opinion is that if PPPs are going to move more mainstream, they need to become a little more institutionalized. He said right now there is a great deal of money spent on transaction costs because the knowledge of the program is not there. He said you need a lot of high-priced talent on both sides of the table, which tends to raise the cost of the transaction. He said if those costs can be lowered, there will be easier ways of doing these transactions.

Mr. Little said PPPs have basically run two ways. The Brownfield assets, which are already built and in operation and the Greenfield assets that are new facilities. The Brownfield assets got an early start with the Chicago Skyway and the Indiana Toll Road, where these facilities were turned over to private operation in exchange for huge upfront payments. The City of Chicago got $1.8 billion. The State of Indiana got $3.2 billion to let someone else have the privilege of operating these facilities and harvesting the revenue. Mayor Daley in Chicago has pretty much identified another Chicago way of doing things. He's been very vocal and upfront about this, and he sees this as the best thing for Chicago. Whether it is the best thing for anyplace else remains to be seen. Greenfield assets, essentially new projects, are what government typically buys when they talk about infrastructure, and there are ways to do those as well.

Mr. Little said the primary benefit of getting the private sector involved on the Greenfield side is the fact that you're getting more infrastructure faster than you would have. It's sort of like do you save up money to buy a car or do you finance it? You pay more if you finance the car, but at least you have the mobility provided by the automobile. It is sort of a trade-off decision that we need to think about with infrastructure.

PPPs basically do two things. They stretch funding out; they let the government take whatever money it has and essentially buy infrastructure on time. And, they also reallocate certain risks. There is a whole range of risks as shown in Slide 20. Mr. Little said there are many ways to do PPPs—Design-Build, Design-Build-Finance-Operate, etc. He said the private sector will be more than happy to do whatever you ask them to do and structure their compensation accordingly. One of the advantages of this is this ability to reallocate risks—not transferring risks. The Big Dig up in Boston is everyone's poster child for a very large project that did not do particularly well from a performance standpoint. There was really no upper bound on this project. It started at $2.6 billion, which was a nonsense figure when it was issued, and everyone knew it. It ended up costing $15.4 or $15.5 billion. That $2.6 billion project was not the same project that was done for $15.5. It grew and they added things onto it along the way. But the fact of the matter is they never had anybody that said, "We will do this for you, and we will charge you X number of dollars, and if we don't come in for that price, it's on us. That's all you're obligated to do is pay that cost." It's not quite that simple, but at least there is this time and cost certainty that generally goes along with the PPP model. The other thing that goes along with this is the fact that when you buy infrastructure this way, it tends to come with a warranty, which is really neat. These people agree to take over operations, and they'll operate it for 25 or 30 years or whatever the time frame is. They'll keep it up all during that time, and when they turn it over to you it is in some acceptable form previously specified.

Mr. Little said North Carolina has pretty good roads. He and his wife drove up to North Carolina through Georgia and South Carolina after flying into Florida, and he found amazing differences in roads as compared to California where they are currently funding about 18 percent of their long-term highway maintenance program. He said the roads in California are pretty awful, and they are awful because they don't have money to keep them up. To buy roads through a PPP process, where someone else is going to do it as part of the cost, strikes Mr. Little as a pretty positive thing because California has not been putting nearly enough money into maintenance or repair. He said maintenance and repair is what the country is going to need more of in the coming decades than it is going to need new capacity.

Mr. Little said there are a lot of risks in a PPP (Slide 21), and a couple stand out. One is construction risks, which is not unique. There are some wonderful contractors in this country, but things come up. It is important to have the specification going in about what is going to be built and the private sector saying what they will build it for. If there are changes, of course that is renegotiated, but the fact is there is certainty there. If there are surprises along the way, the contractor took that on. It should not be, "Oh, gee, we hit this and we need more money." It should be, "We should have seen this."

The second is income risks on things like toll projects and rail projects. Right now we have on the table in this country the question of building a high-speed rail national network. He said rail transport is very capital intensive. At the end of the day, it doesn't pay for itself. He said there is no rational model you can look at for passenger rail that says we're going to recover capital and operating expenses through the fare box. He said people ask him whether they can get the private sector to build this. He said he answers, "If it were a good deal, they would be building it already." He said there may be other things there that we want to accomplish, but we have to be very aware that if you are losing money on every transaction, you can't make it up on volume; so you have to have a workable business model.

Mr. Little said there are other risks like the risk of allocation. There is a project in California for a courthouse in Long Beach that they are trying to build as a PPP. One of the risks that the private sector is still wrestling with, particularly the lenders, is that every year the legislature has to allocate or approve the payment because it is an availability payment structure. He said it is very difficult for a legislature to commit a legislature 20 years down the road to actually do that; and, of course, the private sector is very aware. Mr. Little said there are lots of risks out there, and getting a handle on what they are is extremely important.

A PPP can work for almost anything. Mr. Little said transportation has gotten the most attention, and certainly water and sewer generally from a Brownfield monetization. He said we haven't done social infrastructure quite as much in this county. Social infrastructure is mostly the public building side of things like courthouses, schools, and things that governments tend to build a lot of, like fire stations. Mr. Little said he spent half his career up in Fairfax County in Virginia in the 70s and 80s when they were building a lot of things, and he never understood why something like a fire station has to be an architectural exercise every time they build one. You put the same kind of stuff in a fire station and they're all about the same size. If you want to put mauve stone on the outside of one and pink brick on the other, you can do that; but you shouldn't have to go through a design competition with every one as a separate procurement. He said there are opportunities there that haven't been looked at. He said a lot of countries do hospitals this way, and we tend not to build very many public hospitals, which is probably good because they tend to be tricky.

Project finance is really the key to PPPs because PPPs are basically about leverage. It's about taking a little bit of equity and debt and leveraging their equity into getting more. Mr. Little said given our recent mortgage situation, some might question whether that's the wise place to go. The key is that you take these leverage deals where the private entity is generally a single-purpose or special-purpose vehicle that is established just to do this. So the project lives or dies on its own even though you have big companies and big banks coming in to do this. They are not on the balance sheet for this; it is the project itself. And this non-recourse type of finance tends to work pretty well. It's been around for a while, and the critical thing here to realize is that the public objectives and the objectives of the private sector are not going to perfectly align ever. The more you can get to align, the more important it is; but these people are investors who are out there to make a return on their investment. They are not nearly as interested in providing public services, and they are not nearly as interested in providing some of the social good that the government thinks is extremely important to a project. It is important to keep that in mind because even though this is a partnership, the objectives of both sides are going to be different going in. The more you can bring those together, the more important that is.

Mr. Little referred to an article from the *Financial Times*, which was passed out. (The article is available under 11-30-2010 at the Commission's website at http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121).
The article is about the fact that business schools need to start teaching their students a little bit about public administration. If you're going to go out in the business world, you need to understand that governments don't operate with the same set of metrics.

How the financing typically works (Slide 24). Because project finance is not typical, it is often not real well understood about how it works and what the deal is. There are lots of ways to finance. Mr. Little said basically you have a way to raise money, whether it's tolls or fees or taxes or availability payments. If you have another revenue stream, it is perfectly acceptable to have the private sector build the facility, and you'll tell them that you'll pay them based on the availability of that facility. So if a road is opened under certain conditions previously specified, they get their payment. That doesn't have to come from a direct toll; there are other ways of getting the money. The equity share used to be quite low. Some deals were going through at 10 percent or even less, but there has been a re-balancing. Some are going now at 30 to 40 percent equity—like a much larger down payment on a house.

One of the keys that make the PPP work is that the private sector can depreciate the value of these assets. He said that doesn't actually mean anything to government, but it is something that makes these asset monetizations work. Government at any level owns a whole lot of stuff, but so what? We're not talking necessarily about the state capitol building or the Washington Monument, but the public sector has a lot of money in something that if it could produce revenue, perhaps it should.

At the end of the concession period, the public entity gets something back in a pre-specified condition, which is pretty nice. Mr. Little said his experience generally is that if he were going to get a building back in a pre-specified condition after 30 years of private sector upkeep and repairs or after 30 years of government upkeep and repairs, he would personally go with the private sector because governments tend to forget about keeping buildings up, particularly when times are tough.

Some of the sources of debt for PPPs (Slide 25) are commercial bank loans, bank syndications, or "club deals," which are people getting together to pool the debt. Mr. Little said he thought local banks have a much bigger role to potentially play in the U. S. He said a lot of the credit up to now has been provided by large foreign banks, and there may actually be an opening for local banks. He said North Carolina is a financial hub, and there are banks here that have the capacity to do this.

Build America Bonds (BAB) have been huge in the infrastructure business for the last 18 months. They are basically muni bonds that have taxable interest, so they appeal to a much broader range of investors as opposed to people who want tax-free income. The federal government has been underwriting 35 percent of the interest cost and that's due to go down to 28 percent. Mr. Little said he wasn't sure what the future would be with the change in Washington, but BABs have basically saved municipal debt.

Private Activity Bonds (PAB) are in essence tax exempt bonds private sector for public purposes. Mr. Little said they have been around for quite a while for lots of things, and now they are allowed for highway projects. This is again, basically, a subsidy at the federal level. He said with all the talk about cutting costs and deficit reduction, he is sure some bright light in Washington is going to figure out that even though this isn't money that is going out, it is money that is never collected.

TIFIA is The Innovative Financing Act that was approved two highway bills ago, and has been a major player. Mr. Little said the last four deals that have closed in the U. S. have all had TIFIA components. It's basically either below market loans or loan guarantees.

Mr. Little said there is talk at the national level about a national infrastructure bank. He said he was not optimistic that anything will happen in the next couple of years on this. If an infrastructure bank were actually operated as a real bank that made loans that people paid back, and if there were a mechanism for doing this, Mr. Little thought it could work. He said his sense is that Congress would like a piggy bank to fund pet projects and he didn't think that would work. The infrastructure bank in California worked quite well when it had money going in, but the legislature in the last several years has pulled that money back, so the bank has done less.

Mr. Little said here are opportunities for direct lending by pension funds, other institutional investors, and private individuals.

Some other ways the private sector can participate in PPPs (Slide 16). Mr. Little said almost every state has some kind of special district legislation where property owners can vote to tax themselves for certain improvements, and these are pretty common. Another method is using Tax Increment Financing (TIFs) where the public sector puts up money to provide infrastructure generally to areas that are considered blighted or wanting of revitalization, and the increased property taxes from the increase in property values is used to pay off the debt that is issued to do this. Therefore you have new infrastructure and redevelopment at essentially no cost to anyone. Value capture, is particularly for rail-type facilities where you have stations and a locust of activity where you can put in retail and higher-density housing. You can get the private sector to contribute either right of way or cash for increased development potential for land they own. Mr. Little said this has been very, very effective along rail corridors. He asked the Commission members to ponder what might have happened had the federal government, with all the land they bought during the heydays of the interstate program, if they had actually bought all the interchange sites and if they had all the land where now we have Motel 6s, fuel stations, and Chili's Restaurants. If that had all been in the public domain and they had used the value capture approach, we would have more money than needed to keep the highway system going perpetually. But that wasn't done, and the opportunity is gone.

Critical questions for the public sector to consider about PPP (Slide 27). He said the first question isn't always clearly enunciated:  What do you really want to accomplish? He said it is important to be as specific as possible. Do you have the resources to do that? What's the best way to do it? In the rush to get infrastructure a certain way, are you leaving certain things behind? Is this a way to avoid or short circuit things like environmental protection laws? Out in California, Mr. Little said there is a very stringent state process, California Environmental Quality Act (CEQA), which is actually more stringent than NEPA. He said you certainly don't want to circumvent that. Do you want to deal with disadvantaged business enterprises, small businesses, minority-owned businesses, women-owned businesses? He said you don't want to lose those kinds of things, and you don't want to lose social equity questions. You don't want to create a situation where people who don't have the ability to pay are shut off from certain services. And, of course, the big question is: Where is this process controlled? Mr. Little said right now, particularly for transportation, there is a real desire to keep this at the federal level even though the federal role is diminishing quite a bit. In California they are seeing even the state role being diminished. Most of their new capacity is being done at the county or the regional level as opposed to through the state level. He said it would vary from place to place as far as who actually has the control.

Private Sector Questions (Slide 28). Mr. Little said these are important for government to consider as well. First and foremost, he said the private sector is looking to infrastructure to meet certain investment objectives. Particularly things like pension funds want long stable, long-term returns so they can pay their retirees when the time comes. If infrastructure is not going to meet their investment needs, they are going to take their money and put it in natural gas, or Bolivian tin mines, or something else. Private capital is reasonably fungible; it can go wherever it is going to make a return. Mr. Little said he didn't think PPPs were going to go away, and there are a lot of private sector folks outside this country who are looking to invest in the U. S., but they don't really quite understand (1) why it hasn't gone faster, and (2) what it is we are looking for.

This brought Mr. Little to the second question of whether there is sustainable political commitment to the PPP process. It's like, the current administration likes this, but what happens in two years, or four years, or six years. Is somebody going to change the game? The question about appropriation risks for these longer term availability payments is: What happens in eight years when there is a whole different philosophy in place?

Another question is can they get the financing they need, which has been an issue lately. And, in allocating risks, can they be managed successfully? Can they actually do what they say?

Mr. Little said it is important that the public partner be an educated owner; there needs to be well-informed people on both sides.

Can PPPs work? (Slide 29) Mr. Little said government wants infrastructure to support economic growth and quality of life and minimize life-cycle costs, adequate and timely maintenance and repair, and "off budget" capital improvements. And investors want decent returns and the opportunity to take advantage of the value "locked" in assets, which is often the depreciation, because what we have is assets worth ten's if not hundred's of billions of dollars, and the ability to depreciate that for tax purposes makes them quite valuable. Mr. Little said again that this becomes a de facto federal subsidy, but we tend to count those kinds of subsidies differently. And investors want the ability to use innovation to improve productivity, which actually does happen. Mr. Little said they actually do bring a lot to the table.

The public wants good reliable service at a reasonable price, and they are willing to pay what they think is reasonable. Whether it turns out to be reasonable remains to be seen, but Mr. Little said it is the role of the bully pulpit to convince them that it is.

What do we need to go forward (Slide 30)? We need a clear and explicit understanding of what the goals of both sides are. Mr. Little said the extent to which those goals can brought into alignment is really important. He said that without new revenue, PPPs are not going very far. He doesn't think you can continue to break a dollar into 100 pennies and keep moving the pennies around on the board like we did when we were kids. At some point more money needs to be put on the table. Mr. Little said there are lots of options for where that comes from.

He said in California there has been a tremendous amount of push-back on PPPs from their Department of Transportation, and Mr. Little said he thought a lot of times it is seen as a way to push folks out of the process. He said he favored bringing them into the process. Any consortia wanting to come in and build a highway needs to be willing to maintain and operate the highway. He asked who knows better how to maintain and operate highways in North Carolina than the North Carolina Department of Transportation? Is there a way to hire them out to the private consortia and get them paid that way? He said he didn't necessarily know how to do that, but he thought it was something that hasn't been explored enough.

Involve the all the stakeholders. Mr. Little said a lot of negotiations have tended to take place in small rooms, and people have felt excluded. Certainly the press has a field day when they can write conspiracy stories about what is going on. He said he was a big believer in opening up the process because if it can't stand sunlight it probably shouldn't go forward anyway. And, again, Mr. Little said getting capable and knowledgeable people on both sides cannot be emphasized enough. It's worth spending some money to train people. He said you don't need the $1,000 an hour lawyers on staff, but you certainly need people who are familiar enough with the process who can selectively use those kinds of pricey resources to get exactly what is needed.

Mr. Little said transportation PPPs are alive and well (Slide 31). Texas, Florida, and Virginia have active programs. California, Georgia, and Puerto Rico are moving forward albeit in fits and starts. Several other states, including North Carolina, are looking to do this. There is a lot of complexity in the capital structure as far as what needs to be done. Monetization of parking concessions is very popular. People need to park, and they are pretty good revenue sources that can be flipped into ready cash. High-speed rail has pitfalls. There are places where it is probably a really good idea; there are other places where it is not quite ready for prime time.

Mr. Little said Florida I-595 is a real nice project (Slide 32). It is the first availability fee payment in the country. He said the mix of financing is shown on the left of the slide, and this reached financial close at the height of the financial meltdown. It's a good project that has an existing toll, and he said the state is going to continue to pay that toll and pay the availability fee so it takes some of the popularity issues off the table.

Project Finance: Current Realities (Slide 33). Mr. Little said a lot of the disarray is clearing. A lot of foreign players want to come here because they see the market in Europe drying up. Asia is still going great guns, but Asia is a whole different place. He mentioned local banks getting involved in this, and he said he thought there was more opportunity for direct investment of pension funds. He sees less leverage, going more toward 60/40. The PPP world that existed prior to the financial crises is gone. It was sort of a bubble world, and Mr. Little doesn't think we'll go back there.

Asset Monetization—fad or future (Slide 34)? Mr. Little said they certainly worked for people, and Mayor Daley has made a passion of this in Chicago. Parking has been real big. There was a deal in Pittsburgh that almost went to closing, but there was a change at the end and it didn't go forward. He said the question is: What is the value of this asset over time versus what is the value of having a big bag of money today? He said there are ways to calculate that, but sometimes beyond calculation there are other factors that government has to deal with. But it can work, and Mr. Little said he doesn't see anything wrong with it. He said the fact of the matter is it can put more money on the table to buy other infrastructure, and it gets back to: If we need more money, how are we going to come up with it?

The state of U. S. pension wealth (Slide 35). Mr. Little said the figures are a little bit out of date on the slide, so the total of $13 trillion in pension wealth in the U. S. is really a little big bigger. He said we could actually invest a portion of Social Security. He said his concept for the infrastructure bank is to fund it with Social Security trust funds. Those special securities now get a little bit under 3 percent. Two hundred basis points on a very big number is a very big number, so if they could get 5 percent it would be a way of coming up with infrastructure capital on one hand and retirement security on the other. The big pension funds have money, but what is surprising is the IRAs and the 401Ks. There is a lot of money in those, and Mr. Little thinks there are ways to get investors away to buy into local projects. He said he thought it would be neat if someone could buy $25,000 worth of the Currituck Bridge because people would take a much stronger interest in the bridge if they actually owned a piece of it. He said the fact of the matter is there is a lot of pension capital out there that could be invested in revenue-backed projects.

Concerns a PPP must address (Slide 36). Mr. Little referred to the value for money equation. He said you hear if you go to the private sector it's going to cost more, and what do you get for your money? He said he gave a talk in Delaware in early November, and it was attended by students and practitioners, and there were several people there from Delaware DOT. At the end of the talk somebody raised a point that they had a looked at PPPs a couple of years previously, and they couldn't see how the private sector could actually provide a money saving because the state could issue bonds, which were tax free at a much lower interest rate, and so the advantage seemed to be on the public side. Mr. Little told him that was true; if someone can borrow money for 150 or 200 basis points less, it's hard to see how they can compete with that. Then he asked the question, "So, did you build the project?" They said, no; they decided to do something else. Mr. Little said that was really the key. All too often people look at public option or private option, and then tend to see private option or no project. Mr. Little said workforce issues, social equity, environmental protection can all be dealt with, and he said they certainly have the opportunity to manage risks.

Concerning myths (Slide 37), Mr. Little said his favorite myth is about the gas tax. He said we all know that no one likes the gas tax because it's terrible, but if you drive 20,000 miles a year in a vehicle that gets 20 miles to the gallon, a 10-cent increase in the gas tax will cost you 27 cents a day. Put in context, it is perhaps not as bad as you think. Another myth is that PPPs are always more expensive. Another is that only the public sector can be trusted to do certain things. This comes up a lot with water. The fact is the private sector has been doing this throughout the country for years and years with no loss of quality or safety. If people turn on the tap and get nice clean potable water, they pay their water bill; they don't really care who is providing the service. Concerning the equity of charging for these things, there are lots of ways to help the poor. If you are worried about poor people being able to use toll roads, you can subsidize them. If you go to an availability scheme, then tolls are quite transparent, so there are certainly options.

In closing, Mr. Little said he wanted to leave the Commission with a quote from Pope Stephen during one of the early church councils in the Third Century when they were talking about change. The Pope wasn't a big innovator, and he said, "Let them innovate in nothing, but keep the traditions." Mr. Little said the old ways are not performing acceptably any more, and he thinks we need to experiment and see what works.

Chairman Ross asked if there were questions for Mr. Little from the Commission members. There were none.

Chairman Ross introduced Ms. Mary Nash Rusher to talk about public-private partnerships in North Carolina. She said Ms. Rusher is the managing partner of the Raleigh branch of Hunton & Williams, which is an international law firm with a huge public finance practice. Chairman Ross said she was also her first boss when she was a junior lawyer, and she practiced municipal bond law with Ms. Rusher for four years. Chairman Ross said Ms. Rusher has been working with the Institute for Emerging Issues on public-private partnerships, has done some work at the General Assembly, and has worked on thousands of different kinds of financing deals here in North Carolina and around the country.

Ms. Rusher said she and Rick Little have tag-teamed their presentations several times before, and she said she would try to take some of the broad-brush, big pictures that he brought to the Commission and try to get it closer to home in North Carolina. (A copy of Ms. Rusher's PowerPoint presentation is available on the Commission's website at in the 11-30-2010 folder at: http://www.ncleg.net/gascripts/documentsites/browsedocsite.asp?nid=121.

She said one of the difficulties people have had over the last four or five years talking about PPPs is that PPPs really govern a wide range of things. This was particularly true when the PPPs for Schools statute came through. Everyone was wildly enthusiastic about that concept, but when they got down to the nitty-gritty of figuring out how to make it actually work, they realized that what people had in their heads that was a PPP, and what they were trying to accomplish in that bill, really were not coming together very well. She said what this Commission needs to keep in mind and focus on during the next phases is, "What are we really trying to accomplish when we talk about a PPP?"

She said you can talk about PPPs running in both directions, a PPP where the public is providing support for what is essentially a private endeavor, or the private sector building/developing things that are typically public assets. So the first question will probably be definitional: What are we really talking about?

Ms. Rusher said she put in her presentation a range of things that could be PPP (page 3), starting all the way on the left where it is a public asset where the only private involvement is some chunk of money that permits the private sector to have naming rights. The RBC Center is the closest, near-by example. That is a public asset, publicly owned, publicly financed. But it has some significant private involvement in terms of public dollars that went to it in return for naming rights. On the other extreme you would have privately-built and privately-operated assets that are maintained for the benefit of the government. Where a project falls in this may depend on what sort of legislation you are talking about.

When talking about PPPs, Ms. Rusher said these are the questions you have to ask (page 4): Who is going to build it? Who will own it? Who will operate it? Who will maintain it? Who will finance it? And, who is going to get the profit (excess revenue) from it? And the answers to those questions will dictate where on that spectrum on page 3 you fall. Mr. Little's presentation was focusing specifically on the private construction of infrastructure. But when people talk to you about PPP, that may not be the only thing they have on their minds.

Ms. Rusher said she would point out a couple of ways that we already have PPPs involved with a public sector that is providing some additional dollars to support private endeavors that the public sector has decided are worthwhile (page 5). The most basic of those is incentives, including industrial development bonds, other sorts of private-activity bonds where the federal government has said it will provide a tax break to these sorts of entities that are building assets that Congress has decided are worthy of a tax benefit. That tax benefit is that the people that buy their debt don't pay tax on the income they receive, so it allows the private sector to borrow at a cheaper rate. Industrial development bonds are just manufacturing facilities. Public benefit creates jobs and creates property taxes. Cost to North Carolina, happily, is not much because the only thing is that those are also free from North Carolina income tax, but essentially it is just a conduit borrowing. The credit is purely the credit of the private sector. Recovery zone facility bonds were a much broader category of those that were created by the American Recovery and Reinvestment Act. Those, along with Build America Bonds, will go out of existence unless Congress does something at the end of this year. There are a lot of these bonds racing to the finish line to try to get done before the year is done. There are also special assessment districts and Tax Increment Financing. The Tax Increment Financing came through a

Constitutional amendment. Neither of those tools has been used much. There have been some problems, but lately the problems have been purely the market for those sorts of things. She said those are tools that have been given the public and private sector, and the private sector is working hard to find a way to make those work more readily to get some of that infrastructure built.

There have also been PPPs used in North Carolina in the development and operation of public assets. Each of these required some sort of special legislation in order to be done. So there were jails built by the State of North Carolina using PPPs under various specific legislation that allowed that to happen. She said you will see in many cities parking decks that get built. Often the arrangement will be that as part of a downtown development, the city will want the parking to be built as part of the process, the private developer who is in the middle of building the hotel or the Progress Energy Building or other assets will also build the parking deck and then sell it to the city at the end of the day. And so the city or the county has agreed up front that once the deck is built that they will buy it, or buy some piece of it, or promise to use a certain number of spaces, or provide some public support for that.

Ms. Rusher said there have been convention centers and hotels, both in downtown Raleigh and downtown Charlotte, built with a combination of the public sector and the private sector locking arms and working to get those things built. Schools have been tried, and some have been built. There have been some built under some bits and pieces of legislation across the state, often small, private bills, local bills. It depends on what you are trying to accomplish. Are you trying to accomplish allowing the schools to be built without bidding so that the private sector can bring design-build expertise to it? Are you trying to get the private sector to actually finance the school? There are a lot of issues involved with school financing, so it is really important to get your arms around what you are trying to accomplish with the legislation.

Stadiums have built with PPPs, and then you also will have PPPs that are available in North Carolina in support of private development. This is typically “horizontal” infrastructure, which is the stuff under the ground that you need before you can start building the buildings on top of it. There are water pipes, sewer pipes, roads, curbs and gutters, sidewalks. And those are the things that special assessment bonds, in particular, are well-suited to finance. The legislation is there. There is a lot of work being done by a number of developers working with the Local Government Commission to try to figure out a way to get that financing out into the marketplace.

Ms. Rusher said there are things we have to attention to as we are thinking through how to develop legislation. The constitutional prohibition against lending public credit to a private party has to be a backdrop to any legislation that is providing any sort of public support to a private enterprise.

You always have to pay attention to the public bidding laws or build in some sort of exemption to get around them. Of course that always has to be balanced with the things that we all see are good in public bidding laws. There is a reason we have public bidding laws, so simply throwing them out is not necessarily the right answer.

Ms. Rusher said you need to focus on the cost of borrowing. As Mr. Little pointed out, it is difficult for the private sector to borrow as cheaply as the public sector borrows although these private activity bonds, which are available for water systems, some highway projects, and now some privately-funded school projects do allow the private sector to access tax-exempt dollars. Again, what is it we are trying to accomplish? Is it a project done privately versus a project done publicly? Or, is it a project done privately or no project at all? She said that becomes part of the question.

She said a stumbling block is often the effect of private involvement on the ability of a public entity to get tax-exempt financing. All tax rules that are involved are very careful about how much the private sector can get a tax benefit from that. It's really got to be purely public, and so you have to keep that in mind when looking at it.

She said she would not spend much time on it, but page 8 provides the incentives that are often available to the private sector. She noted that private activity bonds have been used a lot in North Carolina, and particularly this year for recovery zone facility bonds. There have been some very large private projects that were able to take advantage of the really nice confluence of the existing of recovery zone facility bonds and a very cheap debt market to launch some large projects in North Carolina that might not otherwise be here, so that has been a great thing. However, she said she didn't know if Congress sees it that way.

Ms. Rusher said the advantage of private activity bonds is that the governmental entity is merely a conduit; it touches the money as it goes by, which makes it tax exempt. But the credit of the state, the county, or whoever the issuer is, is not pledged so it does not affect the debt rating of the borrowing entity.

Ms. Rusher pointed out industrial development bonds and exempt facility bonds, which are code names under the federal tax code, and she said it was worthwhile to be aware of them because people will talk about them. Industrial development bonds are the ones that you hear about the most, but there are also tax-exempt bonds available for the private sector for private water services, solid waste disposal, airports, private projects at public ports, private sewer systems. She said there's a long list in the code of the sorts of things that can be done with private activity bonds.

Ms. Rusher said she would talk briefly about both tax increment financing and special assessment bonds. She said these are two tools that are available in North Carolina that allow the public sector to capture the increase in value that comes with development in a specified area. So the local government specifies a particular area. It usually works best in a depressed section like in an area of a downtown that needs revitalization. They designate that area, they issue some bonds, they use the proceeds of those bonds often to finance infrastructure or the renovation of a building or some specific thing that is permitted by the statute. Those bonds are then repaid from the increase in the property value that results in that district as a result of that infrastructure, and presumably the follow-on development that comes behind it.

Ms. Rusher said there is a long list of types of assets that can be done using Tax Increment Financing in North Carolina, and the list was actually expanded a couple of years ago.

There was also a provision added in that legislation stating that as long as not more than 25 percent of the project is financed with general obligation bonds, these can be built using a design build arrangement with the private sector. You don't have to go through the public bidding laws. She said there have been very few of these done in North Carolina. There was the entertainment complex in Roanoke Rapids. And, the Town of Woodfin in Buncombe County has authorized $25 million, and $12.9 million have been issued. There is underway a research project in Kannapolis that also expects to use Tax Increment Financing. Some of the projects have been slowed down significantly because of the recession in the last two years.

Special Assessment Financing is a concept similar to TIFs, but different. Ms. Rusher said, again, you create a special assessment district. The creation of it has to be done by petition, the petition has to come from a certain percentage of the property owners within the district, and they can be used for all the same sorts of projects that TIFs can be used for. Historically, special assessments have been used a lot for sidewalks, in particular, where every homeowner is being assessed a certain number of dollars for the proportionate piece of sidewalk that is being laid in front of their house. The concept is that every owner in the district agrees that for this public good, each agrees to allow himself to be taxed. For some of these other things, of course, you have to get public support, but that special assessment then becomes like a property tax and attaches to the property so when that property is sold to the next owner of the lot, that special assessment goes with it just like property taxes go with it. Of course that special assessment, the ability to levy the assessment, to collect on it, and even foreclose on the property to get somebody to pay it becomes the revenue stream that supports the debt that allows you to build the sidewalks or whatever is being put into place.

Ms. Rusher said the General Assembly passed legislation a couple of years ago that broadened the ability to use special assessments to the same laundry list of things that you can use them for for TIFs. It also stretched out the period over which the special assessments could be paid to 30 years of annual installments. It used to be a much shorter period of time, which made it a much higher hit on the property owners. She said the same public bidding rules apply. She said she didn't think any special assessment bonds have been issued in North Carolina; however, there is some conversation going on right now among the private sector that really wants to use it, public entities that really want the private sector to use it in their jurisdiction because they see the potential of what development could come if they could get some help getting the infrastructure in place, and the Local Government Commission to figure out best to get these bonds sold into a market place that fits the LGC's concerns about making sure the credit of North Carolina is kept safe, high, and well regarded and at the time giving these bonds access to the sort of investors who are willing to buy these sorts of bonds.

Ms. Rusher said we have actually had private involvement in revenue producing infrastructure for years. She said there are many private water systems all over the state. There are plenty of instances where public systems have been sold to private operators, and there are instances where private systems have been sold to public operators. The North Carolina Utilities Commission is definitely in the mix when this happens, and Ms. Rusher said she has seen deals fall apart because private operators did not want to be overseen by the Utilities Commission. There have been many, many conversations with private water providers, usually coming in from other states, who want to charge a rate and be able to raise the rates if they need to in order to make a profit. We have to get them to understand that if you are an operator of a revenue-producing system such as a water system or other utility, there will be Utilities Commission oversight involved.

Ms. Rusher said solid waste disposal systems are probably a more obvious example. There are a number of solid waste disposal providers in this state. That is an area where private activity bonds are available to provide tax-exempt financing. There is a public-private partnership going on everyday all across the state where we have private entities providing a public service.

Ms. Rusher shifted over to the more classic concept of PPPs (page 20), which is what Mr. Little talked about, where you have the private sector deeply engaged in providing public infrastructure for a profit. The North Carolina Turnpike Authority (NCTA) has been given so far the power to figure out ways to construct and the power to construct certain specific highway toll projects. The General Assembly gave them specific instructions about how they were to go about the competitive process of finding the private players but then exempted them from the public bidding rules in the actual building of these projects. She said page 21 is an old slide because the Triangle Expressway and the Mid-Currituck Bridge are underway. The Monroe Connector is also underway and, in fact, the state issued Build America Bonds for the first part of the Monroe toll way financing within the last month.

Ms. Rusher said North Carolina has also used PPPs in public and private financing for seven public jails in seven different counties, mostly in the northeast except for Avery County. Those were partly public financed and partly privately financed, but they were definitely privately built and privately operated and then sold back to the State. It was very specific legislation that permitted that whole process to take place.

Parking decks (page 23) have been built a lot where the private sector will build the parking deck as part of what it is building (often in downtown) that the public sector wants and then sell it back to the city or the county. Ms. Rusher said that works under the procurement rules because the city is not overseeing the construction. The city is just buying a finished project or a product at the end of the process. She said it is easier to do that with a parking deck than with a school because the board of education usually has pretty strong ideas about exactly how they want that school to look and how they want it to operate and are less willing to give up control of lots of things about the school.

She said another example (page 24) is the revitalization of Elizabeth Avenue in Charlotte. Charlotte has done a number of these sorts of projects, which are “synthetic TIFs.” A synthetic TIF is where the county will agree that if the developer will do project X, the county will assist with that project either with a direct economic development grant or, in this case it was by buying parking spaces in a parking deck that was being built; but it was used for that purchase, along with the incremental increase in value and property value that resulted from this project. They do the same thing. They create a baseline, they declare the district, and they agree by contract to just use those incremental dollars; but those dollars are not pledged. It is synthetic in that it uses the same concept, but it is not a true pledge of those incremental dollars.

A PPP was used for a conference center/hotel in Raleigh (page 25). That was a combination of public and private dollars. Private dollars built the Marriott, but when it was done they then "condominiumized" the hotel so that the conference space was created as a separate real estate property from the hotel and then sold the conference room space to the City with many pages of contract about who had rights to use that space and when between the City and the developer. Again, it was a way for the City to contribute to the project and get access to meeting space that it desperately needed.

The Sports Arena in Charlotte (page 26) is similar to the RBC Center. There are many issues involved when you have a player like the Bobcats. That's where the private use starts to be a problem, but that's just an example of the interplay between public and private.

Ms. Rusher said there have actually been PPPs used for private road construction, particularly in Charlotte, where again it has been the incremental increase in taxes that has been used to help finance the construction of the roads under a deal between the developer and the City, who had decided from a public perspective that it needed that to happen.

She said she would talk quickly about the PPPs for schools (page 29). She said many people present and several public members of the Commission worked really hard to try to get this statute to work because there was a strong sense that the General Assembly wanted this to work and that this seemed to make sense to let the private sector get involved in the building of schools. Developers were building subdivisions hand over fist, so it made sense to let them build schools in their subdivisions. In that statute, no one clearly answered the question of what are we trying to accomplish, so public bidding was left in. And there was a provision that said it had to be a capital lease, which meant that the developer could not take the depreciation. So you couldn't use that locked-up value to push over to the private sector that might have made it more attractive to them. Either you need to be able to build it more cheaply or you need to build it faster for it to make sense, and at the end of the day because of a number of the provisions that were in the statute, none of the school boards and counties that she worked with were ever able to get to the point that this was either faster or cheaper. They need at least one of the two, if not both, for it to make sense for them to do this. There is a list of those who tried but couldn't get all the pieces together.

Ms. Nash said she has talked a lot with school boards and with the development community about ways to get this done, particularly now with interest rates so crazy low. It is actually possible for the developers often to get credit that is not so much more expensive than it would be if they were doing it in the public sector, but the problem is if the private sector is going to build a school, they want to know for sure in two years that the county is going to have money to purchase it. And a lot of times the very reason the county wants to do this is because they don't have money right now to build a school, and they don't want to borrow money right now to build a school. She said it was very difficult to get a set of county Commissioners, and perhaps not even legal, to bind the county Commissioners two years hence to borrow money to build the school. So it hasn't solved the problem, particularly when there is language in the statute that says if they are going to lease it, it has to be a capital lease. She said they have worked hard to try to find some solutions, and there have been some proposals put on the table that would work where you could have the private sector actually building a school and leasing it under a true operating lease to a local government; but we have never had them work in a tight enough way that either the county could get on board or that a private financier was willing to come to the table.

Ms. Rusher said she and Mr. Little have said this a lot, but the most important thing to do is to lay out what they are trying to accomplish with any legislation. Do you want to build it faster and cheaper? Do you want to shift the construction risk? Do you want to foster economic development? She said answering those questions and the questions she posed at the very front (Who's going to build it? Who will own it? Who will operate it? Who will be responsible for it?) needs to be front of mind when working on legislation to come up with something that's effective.

Chairman Ross asked if there were questions for Ms. Rusher.

Senator Dickson said she was involved in the school legislation. She said she was so hopeful that it would be successful, and she is so disappointed that it hasn't worked the way they wanted it to. She asked if any state has done it better than North Carolina, or is everyone in the same boat.

Ms. Rusher said Jim Copeland, who has worked a lot on the Virginia model, could answer. She said the Virginia model is very clear that what it is fostering is design-built schools. It has focused on the concept that perhaps the private sector can build it faster and perhaps cheaper. She said it has focused on the construction side. It is a procurement method as opposed to a financing method.

On follow-up, Senator Dickson said she thought, too that the same thing is true of schools as fire stations. You can build them from a template. Every one of them doesn't have to be original, and that was part of the concept; but they just didn't do it.

Ms. Rusher said that was done in Johnston County. They had a local bill that very quietly let them build five or six elementary schools from a model that was replicated all over the county, but in order to do that they had to not bid out every single school, and that was part of the legislation.

Representative McGee asked whether there had been any real attempt to have Real Estate Income Trusts (REITs) furnish the money to either help build or buy the lease.

Ms. Rusher asked Mr. Little if he saw REITs much as an investor in these PPP projects, and Mr. Little said not really, mainly because most of the buildings are not revenue-producing. If there were building to lease back to a public owner then they might possibly get involved. He said he was going with the idea that there are other vehicles out there, and he likes the idea that a public project is a way to bring more investors into the mix. He said you can buy into REITs for a small amount and if there was a way to securitize some of these projects where your average person could buy in, it would be neat. He said he thought there were ways to do this and he is talking to people about it, but unfortunately the people who know how to do this have to be enticed. He said there are more ideas out there that they have not yet begun to explore. He said he thought the banking community could be brought into this beneficially and could think of new ideas about getting more people involved. He said once you know where the landmines are, you can draw a map and avoid them. If there is a will to do this, he thinks they can get there. He said this is just the beginning, and there is a lot more opportunity out there.

On follow-up, Representative McGee said REITs have a continual change of ownership and the tax benefits that should flow to the owners may not be available under current legislation because they are considered a capital project.

Ms. Rusher said that was specific to schools. She said part of the reason you won't see a REIT in a school project is because there is no revenue. They are looking for a return. There is rental income, but Ms. Rusher said she understood that they also wanted the depreciation.

Chairman Ross said it was probably an item to explore.

Senator Rucho said they talked about State projects with PPPs, but they also talked about some local projects with cities, town, and counties. He asked whether the State would have any financial obligation or liability if these projects done by local governments failed to deliver in any manner. He wanted to make sure that the credit of the State of North Carolina is not at risk in any of the local projects.

Ms. Rusher said this is what the LGC is always looking out for, but to the extent local governments in North Carolina allow deals to go badly that somehow reflects poorly on the State, she said they don't have any direct impact on the State's financial rating.

On follow-up, Senator Rucho asked if the LGC approves it, whether there is some risk on the part of the State.

Ms. Rusher said she did not think so. She said in every one of the offerings done it says in very large bold letters that neither the faith nor credit of the State of North Carolina is involved in these financings, and she didn't think any investor would ever expect the State to step in and support them.

Chairman Ross said the reason we have the Local Government Commission is because there was a point when a lot our counties and cities went belly up around the Depression. And so the State then did help them. And so this is just a way to provide integrity for local borrowing. to do that in the future. It's not a liability, but sometimes the State is asked to help out, and we don't want to have to do that.

Ms. Shealey said Ms. Rusher indicated there were issues with PPPs as related to the schools in K-12. She asked if there were similar issues at the higher education level or community college level.

Ms. Rusher said the State has not tried yet to put into place any sort of legislation that would allow for PPP financing of either community colleges or any of the university system. She said they do their financing through traditional financing methods, and they build their projects using traditional financing processes. She said there are examples out there, particularly in the student housing world, for State universities (and she was even recently approached about a dorm for a community college) where the private sector will partner with a public university to provide student housing very close to the university, and in return the university will agree to either lease that space from the private developer or to list it as one of their students' housings. So there is a way for the private sector to be involved, but it is not a true PPP where you are thinking of this as a public asset.

Chairman Ross said generally those are receipt supported.

Ms. Shealey said on follow-up that UNC is a public system so the capital projects are public projects, and some have liquidating resources although many don't and previously were funded by bond issues. In going forward, given there is not the availability of resources, she asked what the issues would be for considering non-housing projects at our State universities.

Ms. Rusher said she thought those issues were square on with public schools. You have those exact same sorts of issues of deciding what you want to accomplish. Do we want to make it, for example, so that the universities can go get there projects built more cheaply? Do we want to give them design-built capabilities? Some would say that they already have that in the CMS at-risk process that's available. Do we want to allow for private financing of assets that will eventually be part of the UNC System? She said you would answer some of those questions and then start thinking about what legislation it would take to get there.

Representative Carney said they were talking about the schools, and Charlotte was involved, and she was a part of that school legislation also. She said there was a member of the Commission who was involved and she wondered if Mr. Klein would briefly share the challenges that CMS met in dealing with the county in trying to make the PPP happen.

Mr. Klein said they actually had the financial arrangements to the point that they would have 25 basis points in terms of interest costs to what you could do with a general obligation bond. He said they had rating agencies in New York, and had a financial structure that would work. It took 8 months to get there, but they worked through that very complex structure. What caused them not to proceed were the factors not related to the direct financing; they had public procurement processes involved. They used all the tools in the legislation and went through procurement processes to get there. What happened were local issues. Number one on the side of the county, the county had originally indicated that their goal was "cost less, quicker." They then modified it to "if it's close, quicker." And then they said, "same time is okay." They said, "if you can't make it work, we will do certificates of participation to fund it." That very thing made an easy out because the next issue, and there was a series of issues as they near closing, was off-the-book financing for the county. They were comfortable. It was in essence off-book financing for the school system. The school system though as they were going to the rating agencies was being moved into position to have to generate financial statements for the rating agencies in New York—something they didn't do. It put them in an uncomfortable position at a bad time, so that stumbled in the way a little bit. Secondly, there was a requirement that the lease would be paid out of operating costs for the school system on the capital lease, and the county was in no way willing to guarantee annually that they would have a bracket with the debt obligation or capital lease obligation. They were unwilling to say, "All right, we will always give you at least this line item in the lease." So that was troubling because they knew at the time when they were having to cut costs and operating costs that lease expense perhaps would come out of revenues they had. They looked at sales tax; there was a question of getting through the sales tax reimbursement and looking at dollar to dollar, the county said, "I can get the sales tax reimbursement under our formula." We had to work that out so we could still get the sales tax reimbursement. The last thing was that funding was going to come out of their normal obligations…the charter school got a piece of that money. That added a percentage point on to the cost of the deal just at the bottom line, which then made it non-equitable. They ran out of time to get this project started, and rather than work through it all, they let it go. Mr. Klein said he believed they would have worked through the details had they not said, "We will do certificates of participation."

Chairman Ross said the next meeting would focus on the PPP legislation our neighboring State of Virginia has. She asked Commission members if they had any thoughts about what they might want to know about the Virginia legislation or about other legislation they know of that could be discussed at another meeting. She also asked members for their requests for other information the staff could provide.

Representative McGee said he would like to pursue the capital requirements for the school system.

Chairman Ross said some of the Finance staff could look at that.

There being no further questions, the meeting adjourned at 11:40 a.m. to reconvene on December 15 at 9:30 a.m. in Room 1027.

Respectfully submitted,

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Representative Deborah K. Ross
Presiding Co-Chair

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Margie K. Penven, Committee Assistant